

**Effective Date: April 10, 2000**

**COORDINATED ISSUE  
GAMING INDUSTRY  
THE APPLICABLE RECOVERY PERIOD UNDER I.R.C. § 168 (a) FOR SLOT  
MACHINES, VIDEO LOTTERY TERMINALS AND GAMING FURNITURE,  
FIXTURES AND EQUIPMENT  
UIL 168.20-06**

**ISSUE**

For purposes of determining the appropriate recovery period under I.R.C. § 168(a), are slot machines, video lottery terminals, and gaming furniture, fixtures and equipment:

- qualified technological equipment under I.R.C. § 168(i)(2) entitled to a 5-year recovery period;
- information systems includible in asset class 00.12 Information Systems of Rev. Proc. 87-56, 1987-2 C.B. 674, entitled to a 5-year recovery period;
- "Distributive trades and services" property entitled to a five year recovery period (asset class 57.0) as defined in Rev. Proc. 87-56; or
- assets includible in asset class 79.0 Recreation of Rev. Proc. 87-56, entitled to a 7-year recovery period?

**CONCLUSION**

All of these assets are includible in asset class 79.0 Recreation of Rev. Proc. 87-56. This class includes "assets used in the provision of entertainment services on payment of a fee or admission charge, as in the operation of bowling alleys, billiard and pool establishments, theaters, concert halls, and miniature golf courses." Thus, slot machines, video lottery terminals, and gaming furniture, fixtures and equipment used in recreational business activities are included in asset class 79.0 and are depreciated using a 7-year recovery period, unless the taxpayer is subject to alternative minimum tax ("AMT") and the property was placed in service before January 1, 1999. For property placed in service after December 31, 1998, the recovery period for regular income tax and for alternative minimum tax purposes is the same. I.R.C. §§ 168(g)(2)(C)(i) and 56(a)(1)(A)(i).

**FACTS**

The situations described below are representative of the types of business operations making use of the assets under consideration.

### SITUATION 1

The taxpayer owns gaming devices known as slot machines and video lottery terminals. These devices are placed in various locations such as casinos, bars, hotels, and restaurants. The gaming devices are placed in these locations pursuant to space leases, under which each site owner as lessor leases space to taxpayer as lessee. Taxpayer is responsible for maintaining the gaming devices and accounting for the proceeds from them. The net gaming proceeds are divided between the site owner and the taxpayer.

Taxpayer Position: Taxpayers claim that the gaming devices are either "qualified technological equipment" entitled to a five year recovery period under I.R.C. § 168(i), or "information systems" entitled to a five year recovery period (asset class 00.12), as defined in Rev. Proc. 87-56.

### SITUATION 2

Taxpayer owns and operates a casino/hotel. Slot machines, video lottery terminals, and supporting casino equipment, such as furniture and fixtures for slots, poker, roulette, blackjack, baccarat, bingo, and keno are located throughout the facility and owned by the taxpayer.

Taxpayer Position: Taxpayers claim that gaming devices and supporting equipment, furniture and fixtures are subject to a five year recovery period, under "distributive trades and services" e.g., coin operated dispensing machines, as defined in Rev. Proc. 87-56 (asset class 57.0).

## **LAW AND ANALYSIS**

I.R.C. § 167(a) provides that there shall be allowed as a deduction a reasonable allowance for the exhaustion, wear and tear of property used in a trade or business or held for the production of income.

I.R.C. § 168(a) provides that the depreciation deduction provided by section 167(a) for any tangible property is determined by using the applicable depreciation method, recovery period, and convention.

For purposes of I.R.C. §168(a), the recovery period of depreciable personal property is generally based on the property's class life. I.R.C. § 168(i)(1) defines the term "class life" as meaning the class life, if any, that would be applicable with respect to any property as of January 1, 1986, under I.R.C. § 167(m). These class lives are currently set forth in Rev. Proc. 87-56. Generally, the class lives in Rev. Proc. 87-56 are

associated with particular business activities. Some assets used in all business activities, such as information systems, are grouped in asset classes that are not associated with a particular business activity (i.e., asset classes 00.11 through 0.4). In addition, some types of property, such as "qualified technological equipment," have recovery periods assigned by statute. Assets that fall into the latter two categories are depreciated using the designated recovery period regardless of the particular business activity in which they are actually used.

#### The Gaming Equipment Is Not Qualified Technological Equipment.

I.R.C. § 168(e)(3)(B)(iv) provides that qualified technological equipment is 5-year property. I.R.C. § 168(c) provides that 5-year property has a 5-year recovery period. Under I.R.C. § 168(i)(2)(A)(i) the term "qualified technological equipment" includes any computer or peripheral equipment. I.R.C. § 168(i)(2)(B)(ii) provides that a computer is a programmable electronically activated device capable of accepting information, applying prescribed processes to the information, and supplying the results of these processes with or without human intervention, which consists of a central processing unit containing extensive storage, logic, arithmetic, and control capabilities. I.R.C. § 168(i)(2)(B)(iii) provides that peripheral equipment is any auxiliary machine that is designed to be placed under the control of the central processing unit of a computer. I.R.C. § 168(i)(2)(B)(iv) provides that the term "computer or peripheral equipment" does not include 1) any equipment that is an integral part of other property that is not a computer, 2) calculators, typewriters, copiers, and similar equipment, and 3) equipment of a kind used primarily for the amusement or entertainment of the user.

Slot machines and video lottery terminals do not fit within the definition of "qualified technological equipment" in I.R.C. § 168(i)(2). Qualified technological equipment includes any "computer" and "peripheral equipment." These terms are specifically defined in the I.R.C. provisions set forth above. Unlike computers, slot machines and video lottery terminals do not accept information, process information, or have central processing units containing extensive logic and arithmetic capabilities. Unlike peripheral equipment, slot machines and video lottery terminals are not under the control of a central processing unit of a computer. Slot machines and video lottery terminals are less technologically sophisticated than calculators or copying machines, which are specifically excluded from the computer and peripheral equipment category. These assets are used as gaming devices and their capabilities are limited to gaming and ancillary functions. The I.R.C. provisions discussed above specifically exclude from the computer and peripheral equipment category equipment used primarily for the amusement or entertainment of the user.

#### The Gaming Equipment Is Not Information Systems Property.

Assets includible in asset class 00.12 Information Systems of Rev. Proc. 87-56 are depreciated using a 5-year recovery period. This class includes computers and their peripheral equipment. The class defines "computers" and "peripheral equipment" in the same manner as I.R.C. § 168(i)(2)(B). For the reasons discussed in the preceding

paragraph, slot machines and video lottery terminals are not includible in asset class 00.12.

The Property Is 7 Year Recovery Properties Under Rev. Proc. 87-56 (Asset Class 79.0) Rather Than Property Used In Distributive Trades and Services

As previously discussed, under Rev. Proc. 87-56 the class lives and, therefore, the recovery periods, of depreciable property generally are associated with particular business activities. Asset class 79.0 Recreation includes assets used in the provision of entertainment services on payment of a fee or admission charge, as in the operation of bowling alleys, billiard and pool establishments, theaters, concert halls, and miniature golf courses. Assets used in this business activity that are includible in this class are depreciated using a 7-year recovery period. The business operations making use of the assets under consideration are engaged in the business of gaming. The Tax Court has characterized legal gaming as entertainment. Libutti v. Commissioner, T.C. Memo. 1996-108.

Rev. Proc. 87-56 and its predecessors are based in large part on the Standard Industrial Classification Manual (SIC) published by the Office of Management and Budget. SIC has precise categorization by primary business activity using language very similar to that found in Rev. Proc. 87-56. The asset class numbers for the particular business activities described in Rev. Proc. 87-56 are largely taken from SIC. Major Group 79 of SIC, Amusement and Recreation Services, includes business operations engaged in providing amusement or entertainment services. The SIC classification numbers for operators of coin operated amusement devices and casino operators are 7993 and 7999, respectively.

Taxpayers' argument that slot machines constitute coin operated dispensing machines that fall within the "distributive trades and services" asset class is flawed. Coin operated dispensing machines dispense retail products. Slot machines and other gaming devices do not dispense retail products. They dispense winnings from games of chance played by patrons for entertainment and amusement. Accordingly, they constitute assets that fall within asset class 79.0 for Recreation business activity.

Because taxpayers making use of slot machines, video lottery terminals, and the other supporting casino equipment are engaged in an amusement and recreation services business activity covered by asset class 79.0 of Rev. Proc. 87-56, the property used in that activity must be depreciated using the recovery period prescribed for asset class 79.0. The recovery period for asset class 79.0 is 7 years, unless the taxpayer is subject to AMT and the property was placed in service prior to January 1, 1999. For property placed in service before January 1, 1999, recreational assets in asset class 79.0 have an AMT recovery period of 10 years. I.R.C. §168(g)(2)(C)(i). Property placed in service after December 31, 1998, has the same recovery period for regular and AMT purposes.

The conclusion with respect to the other supporting casino equipment described above assumes that none of this equipment is excluded from asset class 79.0 as property used in all business activities or as property with a recovery period assigned by statute.

A change to correct a taxpayer's consistently used improper depreciation method, recovery period, or convention for computing its depreciation deduction is a change to the taxpayer's method of accounting, subject to the provisions of IRC §§ 446 and 481. Service personnel should process cases accordingly where taxpayers have claimed depreciation using the improper recovery period for their slot machines or other gaming equipment.